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UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

FOR RELEASE ON DELIVERY
EXPECTED AT 10:00 A.M. EDT
WEDNESDAY, MARCH 20, 1980

STATEMENT OF
BALTAS E. BIRKLE, DEPUTY DIRECTOR
COMMUNITY AND ECONOMIC DEVELOPMENT DIVISION

BEFORE THE
SUBCOMMITTEE ON HOUSING AND URBAN AFFAIRS
COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS
UNITED STATES SENATE

SR No 0703

ON
[REVIEW TO ASSESS RENTAL HOUSING
MARKET CONDITIONS]

MR. CHAIRMAN AND MEMBERS OF THE SUBCOMMITTEE:

WE ARE PLEASED TO BE HERE AT YOUR INVITATION TO DISCUSS
OUR REPORT OF NOVEMBER 8, 1979, TO THE CONGRESS ENTITLED
"RENTAL HOUSING: A NATIONAL PROBLEM THAT NEEDS IMMEDIATE
ATTENTION" (CED-80-11).

SCOPE OF REVIEW

THE OBJECTIVE OF OUR REVIEW WAS TO ASSESS THE CONDITION
OF THE RENTAL HOUSING MARKET, BOTH PRIVATE AND SUBSIDIZED, AND
DETERMINE THE MAJOR FACTORS RESPONSIBLE FOR THE CURRENT SITUATION
AND THE EFFECT ON LOWER INCOME HOUSEHOLDS.

WE MADE OUR REVIEW AT HUD HEADQUARTERS IN WASHINGTON, D.C.,
AND HUD FIELD OFFICES IN ATLANTA, GEORGIA; SEATTLE, WASHINGTON;
AND MINNEAPOLIS AND ST. PAUL, MINNESOTA.

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WE INTERVIEWED HUD AND LOCAL HOUSING OFFICIALS; BANKERS, DEVELOPERS, AND OWNERS OF RENTAL PROPERTY; OFFICIALS REPRESENTING TENANT ASSOCIATIONS; AND REPRESENTATIVES OF OTHER ORGANIZATIONS INVOLVED IN RENTAL HOUSING. WE ALSO REVIEWED PERTINENT RECORDS, REPORTS, STUDIES, AND OTHER DATA CONCERNING RENTAL HOUSING.

BACKGROUND

HUD IS THE PRIMARY FEDERAL AGENCY RESPONSIBLE FOR ADMINISTERING PROGRAMS DESIGNED TO ENCOURAGE PRODUCTION OR MAINTENANCE OF RENTAL HOUSING. IN 1949 THE CONGRESS ESTABLISHED A NATIONAL GOAL OF PROVIDING, AS SOON AS FEASIBLE, A DECENT HOME AND A SUITABLE LIVING ENVIRONMENT FOR EVERY AMERICAN FAMILY. HUD'S ROLE IN THE RENTAL HOUSING MARKET HAS BEEN TO (1) PROVIDE FUNDS FOR, OR TO FACILITATE THROUGH MORTGAGE INSURANCE, THE FINANCING OF CONSTRUCTION, PURCHASE, OR REHABILITATION OF MULTIFAMILY HOUSING AND (2) ASSIST LOWER INCOME FAMILIES, THROUGH RENT SUBSIDIES, TO OBTAIN DECENT, SAFE, AND SANITARY HOUSING.

LET ME MENTION SOME IMPORTANT CHARACTERISTICS OF THE RENTAL HOUSING MARKET.

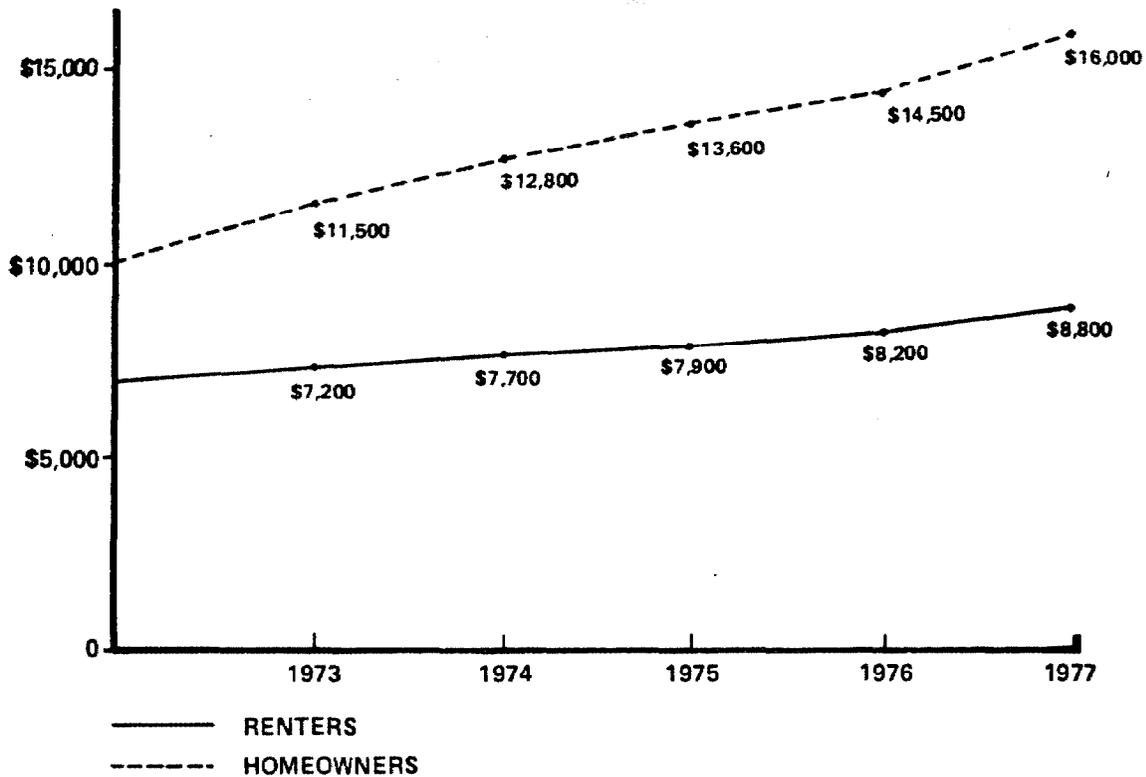
- ABOUT 26 MILLION FAMILIES (ABOUT ONE-THIRD OF ALL FAMILIES) LIVE IN RENTAL HOUSING.
- IN 1977 ABOUT 75 PERCENT OF ALL OCCUPIED RENTAL UNITS (20 MILLION) WERE LOCATED INSIDE STANDARD METROPOLITAN STATISTICAL AREAS. OF THESE, ABOUT 59 PERCENT WERE LOCATED INSIDE CENTRAL CITIES.
- SINGLE-FAMILY HOUSING UNITS MAKE UP ALMOST ONE-THIRD OF ALL RENTER-OCCUPIED UNITS WHILE MULTIFAMILY STRUCTURES (FIVE OR MORE UNITS) ACCOUNT FOR APPROXIMATELY 39 PERCENT.

--THE NATION'S RENTAL HOUSING INVENTORY IS RELATIVELY OLD. ACCORDING TO THE 1977 ANNUAL HOUSING SURVEY, ABOUT 63 PERCENT OF ALL RENTER-OCCUPIED HOUSING UNITS ARE IN STRUCTURES BUILT BEFORE 1960; ABOUT 41 PERCENT OF ALL RENTER-OCCUPIED HOUSING UNITS ARE IN STRUCTURES BUILT BEFORE 1940.

FINDINGS

TODAY ABOUT 35 PERCENT OF AMERICAN FAMILIES LIVE IN RENTAL HOUSING AND ARE FACED WITH THE NATION'S LOWEST RECORDED VACANCY RATE. RENTERS ARE FINDING IT INCREASINGLY DIFFICULT TO LOCATE AFFORDABLE RENTAL UNITS. HARDEST HIT ARE THE MILLIONS OF RENTERS WITH ANNUAL INCOMES OF LESS THAN \$10,000. IN ADDITION, THERE IS LIMITED POTENTIAL FOR MOST OF THESE RENTERS TO BECOME HOMEOWNERS CONSIDERING THE RAPIDLY RISING COST OF BUYING AND MAINTAINING A HOUSE.

RENTERS, BY AND LARGE, HAVE LOWER INCOMES THAN HOMEOWNERS. ALTHOUGH THE ANNUAL MEDIAN INCOMES OF ALL HOUSING OCCUPANTS HAVE INCREASED SINCE 1973, THE INCREASE FOR RENTERS HAS BEEN MUCH LESS THAN THE INCREASE FOR HOMEOWNERS. THE FOLLOWING GRAPH, BASED ON ANNUAL HOUSING SURVEY DATA, ILLUSTRATES THIS TREND.



AS SHOWN, WHILE THE MEDIAN INCOME OF RENTERS ROSE FROM \$7,200 TO \$8,800 (AN AVERAGE ANNUAL INCREASE OF 5.6 PERCENT), THE MEDIAN INCOME OF HOMEOWNERS INCREASED FROM \$11,500 TO \$16,000 (AN AVERAGE INCREASE OF 9.8 PERCENT PER YEAR). MORE SIGNIFICANTLY, THE MEDIAN INCOME OF RENTERS IN 1977 (\$8,800) WAS 55 PERCENT THAT OF HOMEOWNERS (\$16,000).

SINCE 1970 RENTERS' RENT-TO-INCOME RATIO HAS STEADILY INCREASED. ALTHOUGH THE GENERALLY ACCEPTED RULE OF THUMB IS THAT RENT SHOULD NOT BE MORE THAN 25 PERCENT OF A FAMILY'S INCOME, IN 1977 ABOUT 49 PERCENT (11.9 MILLION) OF ALL RENTERS PAID 25 PERCENT OR MORE OF THEIR INCOME FOR RENT. ABOUT 30 PERCENT (7.4 MILLION) OF ALL RENTERS PAID 35 PERCENT OR MORE OF THEIR INCOME FOR RENT WITH 4.2 MILLION OF THESE RENTERS PAYING MORE

THAN 50 PERCENT. OF THE 7.4 MILLION RENTERS PAYING 35 PERCENT OR MORE, ABOUT 86 PERCENT HAD ANNUAL INCOMES OF LESS THAN \$7,000.

THE NATIONAL RENTAL VACANCY RATE HAS BEEN DECLINING SINCE 1974. DURING 1979 THE VACANCY RATE RANGED BETWEEN 4.8 AND 5.2 PERCENT. FAMILIES NEEDING LARGER UNITS ARE FINDING IT MORE DIFFICULT TO LOCATE SUITABLE HOUSING BECAUSE THE NATIONAL VACANCY RATE WAS ABOUT 3.8 PERCENT FOR HOUSING UNITS WITH FIVE ROOMS AND ABOUT 2.8 PERCENT FOR THOSE WITH SIX OR MORE ROOMS.

OUR NATION'S RENTAL HOUSING MARKET HAS REACHED A CRISIS. THE PRIMARY FACTORS RESPONSIBLE FOR THIS CRISIS ARE LOW LEVELS OF MODERATELY PRICED NEW PRIVATE CONSTRUCTION (IN 1978 ONLY 42,000 UNITS, OR 18 PERCENT OF THE TOTAL UNITS COMPLETED, RENTED FOR \$199 PER MONTH OR LESS) AND LOSSES OF EXISTING UNITS THROUGH ABANDONMENTS AND CONVERSIONS TO CONDOMINIUMS. OTHER FACTORS, SUCH AS RAPIDLY ESCALATING OPERATING COSTS AND THE INCREASING AGE OF THE EXISTING RENTAL STOCK, ARE ALSO HAVING A DETRIMENTAL EFFECT.

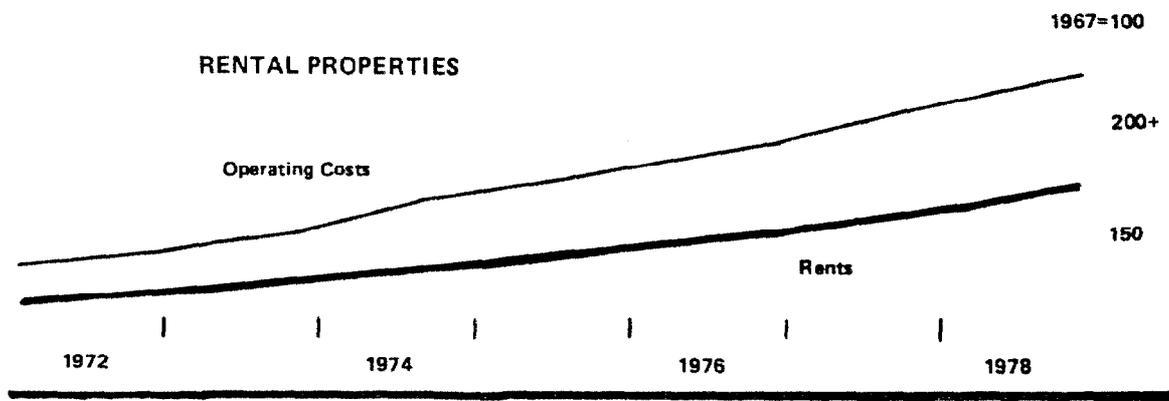
HISTORICALLY, THE PRIVATE SECTOR AND THE FEDERAL GOVERNMENT HAVE SHARED THE BURDEN OF PROVIDING MULTIFAMILY RENTAL HOUSING WITH THE PRIVATE SECTOR DOMINATING THE MARKET. HOWEVER, THE PROPORTION OF FEDERALLY SUBSIDIZED MULTIFAMILY RENTAL CONSTRUCTION STARTS HAS INCREASED STEADILY FROM 22 PERCENT IN 1972 TO ABOUT 44 PERCENT IN 1978. HUD ESTIMATED THAT FEDERALLY SUBSIDIZED OR INSURED UNITS WOULD ACCOUNT FOR ABOUT 75 PERCENT OF MULTIFAMILY CONSTRUCTION STARTS IN 1979. IF THE CURRENT RENTAL MARKET CONDITIONS CONTINUE, THERE WILL BE EVEN GREATER RELIANCE ON FEDERAL HOUSING PROGRAMS, PARTICULARLY FOR LOWER INCOME HOUSEHOLDS.

DESPITE THE INCREASED DEPENDENCE ON THE FEDERAL GOVERNMENT TO PROVIDE MULTIFAMILY RENTAL HOUSING, THE NUMBER OF HOUSEHOLDS IN NEED OF AND QUALIFIED TO GET ASSISTANCE FAR EXCEEDS THE NUMBER OF SUBSIDIZED UNITS THE GOVERNMENT IS ABLE TO PROVIDE. FOR EXAMPLE, HUD ESTIMATED THAT 10.1 MILLION LOWER INCOME RENTER HOUSEHOLDS WERE IN NEED OF HOUSING ASSISTANCE IN 1979 EITHER BECAUSE THEY WERE LIVING IN SUBSTANDARD OR OVERCROWDED HOUSING OR BECAUSE THEY WERE PAYING MORE THAN 25 PERCENT OF THEIR INCOME FOR RENT. ACCORDING TO HUD DATA, ABOUT 252,000 ASSISTED UNITS WERE MADE AVAILABLE FOR OCCUPANCY IN FISCAL YEAR 1979.

OFFICIALS CITED VARIOUS REASONS FOR THE DECLINING PRIVATE RENTAL HOUSING MARKET, INCLUDING HIGH COSTS OF CONSTRUCTION, LAND, AND FINANCING AND INSUFFICIENT RENTS. MOST OFFICIALS AGREED THAT AT CURRENT RENT LEVELS NEWLY CONSTRUCTED, PRIVATELY FINANCED RENTAL UNITS WERE NOT PROFITABLE. IT WAS SUGGESTED THAT A 20- TO 25-PERCENT INCREASE IN MARKET RENTS WOULD BE NECESSARY TO STIMULATE NEW INVESTMENT IN THE PRIVATE MULTIFAMILY RENTAL MARKET. MOST DEVELOPERS CONSIDERED SUCH INCREASES TO BE INFEASIBLE DUE TO LOCAL RENT CONTROL (OR THREAT OF IT) AND RENTERS' GENERALLY LOWER INCOMES.

RAPID INCREASES IN THE COST TO OPERATE AND MAINTAIN EXISTING RENTAL HOUSING, PARTICULARLY UTILITY COSTS, HAVE ALSO BECOME A MAJOR CONCERN. A HUD TASK FORCE REPORTED THAT INCREASES IN SUCH COSTS ARE PRIMARILY RESPONSIBLE FOR RISING TRENDS IN APARTMENT ABANDONMENTS, FORECLOSURES, AND CONVERSIONS.

ACCORDING TO THE MARCH 1977 AND MARCH 1979 "FEDERAL RESERVE BULLETIN," MANY OWNERS OF RENTAL HOUSING HAVE BEEN CAUGHT IN A PROLONGED COST-REVENUE SQUEEZE, AND REPAYMENT PROBLEMS ON OUTSTANDING LONG-TERM MULTIFAMILY MORTGAGES HAVE RESULTED. THE AVERAGE EXPENSE OF OPERATING RENTAL PROJECTS, ACCORDING TO THE FEDERAL RESERVE, HAS RISEN AT A CONSIDERABLY FASTER PACE THAN RENTS. THIS TREND IS REFLECTED IN THE GRAPH AS SHOWN.



SOURCE: FEDERAL RESERVE BULLETIN.

THE GREATEST INCREASES HAVE BEEN IN THE COSTS OF FUEL AND UTILITIES, ALTHOUGH ALL MAJOR COST COMPONENTS HAVE INCREASED SIGNIFICANTLY. MEANWHILE, RENT CONTROLS (OR THE THREAT OF THEM) HAVE LIMITED RENT INCREASES IN SOME AREAS. THE FEDERAL RESERVE CONCLUDED THAT PROSPECTIVE RETURNS ON MULTIFAMILY RENTAL PROJECTS HAVE FREQUENTLY BEEN TOO LOW AND/OR UNCERTAIN TO WARRANT NEW INVESTMENT.

THE AGE OF THE NATION'S RENTAL HOUSING STOCK IS ALSO A SIGNIFICANT FACTOR. A LARGE PORTION OF LOWER INCOME RENTERS LIVE IN RENTAL UNITS LOCATED IN STRUCTURES THAT ARE AT LEAST

40 YEARS OLD. DURING 1977 ABOUT 11 MILLION RENTAL UNITS, OR 41 PERCENT OF ALL OCCUPIED RENTAL UNITS, WERE LOCATED IN STRUCTURES BUILT IN 1939 OR EARLIER. ALTHOUGH HOUSING DOES NOT NECESSARILY DETERIORATE WITH AGE, OLDER HOUSING TYPICALLY COSTS MORE TO OPERATE AND MAINTAIN THAN NEWER HOUSING. FOR EXAMPLE, ITEMS SUCH AS BOILERS AND ENERGY DISTRIBUTION SYSTEMS WEAR OUT OR BECOME INEFFICIENT TO OPERATE AND NEED TO BE UPGRADED OR REPLACED.

THE AGE-COST RELATIONSHIP IS SIGNIFICANT RELATIVE TO RENTER AFFORDABILITY BECAUSE 64 PERCENT (OR 7 MILLION) OF THE RENTAL UNITS IN STRUCTURES BUILT IN 1939 OR EARLIER ARE OCCUPIED BY HOUSEHOLDS EARNING LESS THAN \$10,000 ANNUALLY. ALSO, THE MEDIAN INCOME OF HOUSEHOLDS OCCUPYING SUCH UNITS WAS \$7,500 COMPARED TO THE OVERALL RENTER MEDIAN INCOME OF \$8,800.

THE CONVERSION OF RENTAL UNITS TO CONDOMINIUMS IS INCREASING-- 145,000 CONVERSIONS IN 1979 COMPARED TO 50,000 DURING 1977. LOW RATES OF RETURN FROM RENTAL OWNERSHIP IS CONSIDERED A PRIMARY CAUSE OF THE GROWING TREND TO CONVERSIONS. ACCORDING TO A JOINT ECONOMIC COMMITTEE REPORT OF NOVEMBER 1978 ENTITLED "MULTIFAMILY HOUSING DEMAND: 1975-2000," THE INCREASING TREND TO CONVERSIONS INDICATES THAT PRIVATE RENTAL OPERATORS ARE RELUCTANT TO CONTINUE OPERATIONS DESPITE PREFERENTIAL TAX LEGISLATION.

WHILE MUCH ATTENTION HAS BEEN GIVEN TO WAYS OF STIMULATING NEW CONSTRUCTION, LESS EMPHASIS HAS BEEN DIRECTED TOWARD PRESERVING OF EXISTING RENTAL HOUSING, PARTICULARLY OLDER STRUCTURES. GIVEN THE HIGH PERCENTAGE OF LOWER INCOME TENANTS OCCUPYING SUCH

HOUSING, THE CONGRESS AND THE ADMINISTRATION SHOULD PLACE A HIGH PRIORITY ON ASSURING THAT THE EXISTING STOCK REMAINS VIABLE AND CONTINUES TO BE AVAILABLE AND AFFORDABLE TO LOWER INCOME TENANTS.

ALTHOUGH NEW CONSTRUCTION PLAYS AN IMPORTANT ROLE IN THE RENTAL HOUSING MARKET, RENTAL HOUSING PROBLEMS CANNOT BE SOLVED SOLELY THROUGH THIS MECHANISM--THE PUBLIC AND PRIVATE SECTORS' ABILITY TO PRESERVE THE EXISTING STOCK, BOTH PHYSICALLY AND FINANCIALLY, MUST ALSO BE IMPROVED.

DURING OUR REVIEW WE MET WITH NUMEROUS HOUSING OFFICIALS, WHO MADE MANY SUGGESTIONS FOR DEALING WITH THE RENTAL HOUSING PROBLEM. CLEARLY THERE ARE NO SIMPLE SOLUTIONS. IMPROVEMENTS WILL COME ONLY IF ALL INVOLVED PARTIES ARE WILLING TO MAKE SACRIFICES AND WORK TOGETHER TO DEVELOP AND IMPLEMENT ACCEPTABLE POLICIES.

RECOMMENDATION TO THE CONGRESS

THE RENTAL HOUSING PROBLEM IS SO SEVERE THAT IT REQUIRES THE IMMEDIATE ATTENTION OF AND ACTION BY THE CONGRESS AND THE ADMINISTRATION. THEREFORE, WE RECOMMENDED THAT THE CONGRESS ESTABLISH A COMMISSION CONSISTING OF OFFICIALS FROM FEDERAL (BOTH EXECUTIVE AND LEGISLATIVE), STATE, AND PRIVATE ORGANIZATIONS TO (1) DEVELOP ALTERNATIVE STRATEGIES TO MINIMIZE THE IMPACT OF THE CRISIS WHICH RECOGNIZE, AMONG OTHER THINGS, THE PRESERVATION OF EXISTING STOCK AS WELL AS NEW CONSTRUCTION OF RENTAL HOUSING AND IDENTIFY INCENTIVES NECESSARY FOR PRIVATE INDUSTRY TO ENLARGE ITS ROLE IN THE RENTAL MARKET AND (2) PROPOSE A NATIONAL RENTAL HOUSING POLICY AND PLAN OF ACTION TO FOSTER THE AVAILABILITY AND AFFORDABILITY OF RENTAL HOUSING.

RECOMMENDATION TO THE OFFICE
OF MANAGEMENT AND BUDGET

WE RECOMMENDED THAT THE DIRECTOR, OFFICE OF MANAGEMENT AND BUDGET, TAKE THE LEAD IN DEVELOPING EXECUTIVE BRANCH ALTERNATIVES AND STRATEGIES WHICH FOCUS ATTENTION ON THE RENTAL HOUSING CRISIS. THESE ALTERNATIVES AND STRATEGIES SHOULD BE PRESENTED TO THE COMMISSION FOR USE IN FORMULATING A NATIONAL RENTAL HOUSING POLICY.

AGENCY COMMENTS

IN AUGUST 1979 WE REQUESTED COMMENTS ON OUR DRAFT REPORT FROM HUD AND THE OFFICE OF MANAGEMENT AND BUDGET. HOWEVER, NEITHER AGENCY GAVE US WRITTEN COMMENTS SO THE REPORT WAS ISSUED WITHOUT THEM.

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WE UNDERSTAND THAT SENATOR WILLIAMS HAS BEEN CONSIDERING LEGISLATION THAT WOULD MODIFY TAX INCENTIVES FOR THE PRODUCTION OF RENTAL HOUSING AND TO GIVE TENANT ORGANIZATIONS THE FIRST RIGHT TO PURCHASE RENTAL BUILDINGS SLATED FOR CONVERSION TO CONDOMINIUMS. TAX INCENTIVES INCLUDE:

- GIVING RENTAL HOUSING AT LEAST AS FAVORABLE DEPRECIATION TREATMENT AS COMMERCIAL REAL ESTATE WOULD RECEIVE UNDER THE CAPITAL COST RECOVERY BILLS, (H.R. 4646 AND S. 1435), WHICH ARE STILL PENDING BEFORE HOUSE AND SENATE COMMITTEES.
- OFFERING INVESTORS THE CHOICE OF USING THE 10-YEAR DEPRECIATION SCHEDULE OR TAKING AN IMMEDIATE 10 PERCENT INVESTMENT TAX CREDIT ON TOTAL CONSTRUCTION COSTS OF RENTAL HOUSING.

--MAKING PERMANENT SEVERAL EXISTING TAX BREAKS FOR HOUSING, INCLUDING ALLOWANCES FOR DEDUCTION WHEN PAID OF CONSTRUCTION PERIOD INTEREST AND TAXES ON LOW INCOME HOUSING PROJECTS, SET TO EXPIRE DECEMBER 31, 1981; SECTION 167(k) FIVE-YEAR WRITE-OFFS FOR EXPENDITURES TO REHABILITATE LOW-INCOME HOUSING, WHICH EXPIRES AT THE END OF 1981 ALSO; THE FIVE-YEAR WRITE-OFF FOR HISTORIC PRESERVATION EXPENDITURES, WHICH EXPIRES JUNE 15, 1981; AND PROVISIONS FOR ACCELERATED DEPRECIATION FOR SUBSTANTIAL REHABILITATION OF HISTORIC PROPERTIES, WHICH EXPIRES JULY 1, 1981.

THE HOUSE SUBCOMMITTEE ON HOUSING AND COMMUNITY DEVELOPMENT HAS ESTABLISHED A RENTAL HOUSING TASK FORCE. THE TASK FORCE IS HOLDING HEARINGS DURING MARCH 1980 AND PLANS TO REPORT ON ITS FINDINGS DURING APRIL 1980.

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THIS CONCLUDES MY PREPARED TESTIMONY AND I WILL BE GLAD TO RESPOND TO ANY QUESTIONS WHICH YOU OR MEMBERS OF THE SUBCOMMITTEE MAY HAVE.